



***Michael C. Schlachter, CFA  
Managing Director & Principal***

March 22, 2011

Dr. Louis Moret  
Chair, Investment Policy Subcommittee  
California Public Employees' Retirement System  
400 Q Street  
Sacramento, CA 95814

Re: Revision of Policy on Asset Allocation Strategy

Dear Dr. Moret:

You requested Wilshire's opinion with respect to the proposed revisions to the Statement of Investment Policy for Asset Allocation Strategy.

### **Recommendation**

**Wilshire recommends that the Policy Subcommittee adopt the revised asset allocation targets and the language regarding the strategic purpose of each asset class as presented. However, Staff has also proposed up to a doubling of the tracking error target for the total fund "under normal circumstances" and we believe that this proposal should require considerable debate and discussion before it is accepted.**

### **Background**

The revisions to the policy document that formally accept the asset allocation decision made last fall and present a transition plan for moving to the new asset allocation targets are acceptable to us. Although the plan appears to take two full years to fully implement the new asset allocation targets, we note that all asset classes are already within the allowable ranges specified within the policy and that the vast majority of any needed transitions will be completed by the end of the calendar year.

We also support Staff's proposal to add language requiring that each asset class have a defined "strategic role" in asset allocation. Given the creation a few years ago of a new asset class that has the intention of outperforming inflation and the new move toward defining asset classes primarily by the functional roles they play in asset allocation (growth, income, liquidity, etc), we believe that a clear statement of the purpose of each asset class is well warranted.

However, we believe that the Policy Subcommittee should discuss with Staff the proposal in section VI.F to increase the targeted tracking error from 1.50% for the Total Fund to a range of up to 3.00% "under



normal market conditions” and up to 4.00% in “volatile market conditions.” In our recollection, there has been no prior discussion with the Investment Committee regarding such a substantial increase in the relative risk profile of the Total Fund and we do not believe that such a change should be adopted through the Policy Subcommittee without significant discussion.

Please let us know if you have any questions or comments.

Best regards,

A handwritten signature in black ink, appearing to read 'Michael A. ...', with a long, sweeping horizontal line extending to the right.